No. 77-910

In the Supreme Court of the United States

OCTOBER TERM, 1977

GOVERNMENT OF THE VIRGIN ISLANDS,
ET AL., PETITIONERS

v.

VITCO, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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This brief is submitted in response to the Court's invitation to the Solicitor General to express the views of the United States.

QUESTION PRESENTED

Whether a Virgin Islands corporation, which is a subsidiary of a United States corporation, is required to withhold the 30 percent Virgin Islands tax on dividends distributed to its United States parent.

STATUTES INVOLVED

The pertinent parts of Section 1, Act of July 12, 1921, 42 Stat. 122 (48 U.S.C. 1397), of Section 28(a), Revised Organic Act of the Virgin Islands, 68 Stat. 508 (48 U.S.C.

1642), and of Sections 881, 1441, 1442 and 7701 of the Internal Revenue Code of 1954, as amended (26 U.S.C.), are set forth at Pet. App. C, pp. 1c-7c.

STATEMENT

Respondent is a Virgin Islands corporation and a wholly-owned subsidiary of Chase Instruments Corporation, a New York corporation. During the years in issue, 1970 through 1972, respondent had no office or employees in the Virgin Islands. It maintained its principal place of business together with its parent in Lindenhurst, New Jersey. Respondent's business consisted primarily of leasing machinery and equipment, which was located in the Virgin Islands and in the continental United States. Most of respondent's revenues were attributable to equipment located in the continental United States. Respondent received its machinery rental and interest income in the United States (Pet. App. A, p. 3a; Pet. App. B, pp. 2b-3b).

During 1970-1972, respondent filed United States corporate income tax returns and paid United States taxes on its income from equipment leasing and interest. It also filed income tax returns with the Commissioner of Finance of the Virgin Islands for the same years, and claimed the taxes it paid to the United States as foreign tax credits. However, the Commissioner of Finance of the Virgin Islands took the position that respondent should have paid taxes on all of its income to the Virgin Islands rather than to the United States and should have withheld the 30 percent tax on the gross amount of dividends respondent paid to its parent, Chase (Pet. App. A, p. 3a; Pet. App. B, pp. 3b-4b). The district court ruled in favor of the Government of the Virgin Islands (Pet. App. B, pp. 1b-11b).

The court of appeals reversed. It agreed with the district court that respondent was required to pay tax on all of its income to the Virgin Islands (Pet. App. A, pp. 1a-8a). However, it held that respondent was not required to withhold the 30 percent tax on the dividends distributed to Chase (Pet. App. A, pp. 9a-14a). Although the court acknowledged that 26 U.S.C. 1442 as applied in the Virgin Islands "standing alone, would appear to authorize the Virgin Islands to require Vitco, a Virgin Islands source, to withhold 30% of the dividends payable to Chase, a foreign corporation" (Pet. App. A, p. 9a), it concluded that Treasury Regulations, Section 1.1441-4(d) (26 C.F.R.), "provides a special exemption [for inhabitants of the Virgin Islands] which negates the apparent effect of the statute" (Pet. App. A, p. 10a).

ARGUMENT

1. a. Since the enactment of the Naval Service Appropriations Act of July 12, 1921, 42 Stat. 122, Congress has prescribed that "[t]he income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands * * *" (48 U.S.C. 1397; Pet. App. C, p. 1c).

The Act created a separate territorial income tax for the Virgin Islands based upon the United States tax law. However, to give the Internal Revenue Code proper effect in applying it to the Virgin Islands, the words "Virgin Islands" are generally to be substituted for the words "United States." Similarly, Virgin Islands corporations are domestic corporations under the Virgin Islands tax law; conversely, United States corporations are deemed to be foreign corporations. Since the Virgin Islands tax law

is the Internal Revenue Code with the necessary changes to reflect the Virgin Islands, the reverse nomenclature of the Virgin Islands tax law is commonly described as a "mirror" provision. *Dudley* v. *Commissioner*, 258 F. 2d 182, 185 (C.A. 3); *Chicago Bridge and Iron Co.* v. *Wheatley*, 430 F. 2d 973, 975 (C.A. 3), certiorari denied, 401 U.S. 910; *Great Cruz Bay, Inc., St. John, Virgin Islands* v. *Wheatley*, 495 F. 2d 301, 302-305 (C.A. 3); *Sayre & Company* v. *Riddell*, 395 F. 2d 407, 408-409, 411-413 (C.A. 9) (*en banc*); S. Rep. No. 92-437, 92d Cong., 1st Sess. 70 (1971); S. Rep. No. 1767, 86th Cong., 2d Sess. 2-3 (1960); S. Rep. No. 2176, 85th Cong., 2d Sess. 5-6 (1958); I.T. 2946, XIV-2 Cum. Bull. 109 (1935), superseded by Rev. Rul. 73-315, 1973-2 Cum. Bull. 225.

Section 881 of the 1954 Code (Pet. App. C, pp. 2c-3c), as applied in the Virgin Islands, imposes a 30 percent tax on certain types of Virgin Islands-source income, such as dividends and interest received by foreign corporations, when that income is not effectively connected with the conduct of a trade or business in the Virgin Islands. Sections 1441 and 1442 of the Code (Pet. App. C, pp. 4c-7c) require the payor of such income to withhold 30 percent of the gross amount paid to the foreign corporation to insure that the Virgin Islands tax is paid. In this case, the import of these statutes is that Chase is liable for Virgin Islands tax upon the dividends it received from respondent and that respondent was required to withhold 30 percent of the gross amount of the dividends paid to Chase.

b. The court of appeals acknowledged that "[u]sing the mirror technique, the statute, standing alone, would appear to authorize the Virgin Islands to require Vitco, a Virgin Islands source, to withhold 30% of the dividends

payable to Chase, a foreign corporation" (Pet. App. A, p. 9a). However, it held that Section 1.1441-4(d) of the Treasury Regulations "provides a special exemption which negates the apparent effect of the statute" (Pet. App. A, p. 10a).

The Regulation provides an exemption from the withholding requirements for payments of income to certain inhabitants of the Virgin Islands. It states as follows:

> No withholding is required under § 1.1441-1 upon any item of income paid to any person who at the time of payment reasonably expects to satisfy his income tax obligations with respect to that item under Section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642). That section provides that all persons whose permanent residence is in the Virgin Islands "shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the Treasury of the Virgin Islands."

Contrary to the conclusion of the court of appeals, Section 1.1441-4(d) has no application to this case. By its terms, it applies only when the recipient of dividend or interest income from United States sources is a permanent resident of the Virgin Islands and thereby liable for Virgin Islands tax upon his world-wide income. Thus, if a United States-subsidiary distributed a dividend to its Virgin Islands parent, the subsidiary would not be required to withhold the 30 percent United States tax. The parent is subject to Virgin Islands tax on all of its income pursuant to Section 28(a) of the Revised Organic Act of the Virgin Islands. There would accordingly be no reason to withhold United States taxes from such income.

This case presents the converse situation. Here, respondent, a Virgin Islands corporation, distributed a dividend to Chase, its United States parent. By virtue of Sections 1441 and 1442 as applied in the Virgin Islands, respondent was required to withhold the 30 percent Virgin Islands tax upon this dividend income. But since Chase is not a permanent resident of the Virgin Islands under Section 28(a) of the Revised Organic Act, Chase is not eligible for the Regulation's special exemption from the withholding requirements for residents of the Virgin Islands. We therefore agree with the Government of the Virgin Islands that the court of appeals erred in holding that respondent was not required to withhold the 30 percent Virgin Islands tax from its dividend distribution to Chase.

The court of appeals attempted to buttress its conclusion by stating that "if the regulation as well as the underlying statute is mirrored, there can be no withholding on dividend income paid by a Virgin Islands corporation to a United States (foreign) corporation" (Pet. App. A, p. 10a). But there is no basis for "mirroring" the Regulation, the application of which specifically requires that the recipient of the income be a permanent resident of the Virgin Islands subject to a tax of that jurisdiction under Section 28(a) of the Revised Organic Act of the Virgin Islands. Since Chase is not able to satisfy its tax obligations on all of its income to the Virgin Islands as a resident of that jurisdiction under Section 28(a) of the Revised Organic Act, the Regulation does not apply to distributions from its Virgin Islands subsidiary.[1]

[1] *Sayre & Company* v. *Riddell, supra*, upon which the court of appeals relied (Pet. App. A, pp. 11a-12a), actually supports the Government of the Virgin Islands. There, the court held that under the mirror provisions of the Guam income tax, Guam could impose the 30 percent tax on interest paid by a Guam sole proprietorship to a United States corporation. The basis of the decision is that under Section 881, a United States corporation is considered to be a foreign corporation for Guam income tax purposes and thereby subject to the 30 percent tax.

In 1972, Congress overruled the result in *Sayre* by adding to Sections 881 and 1442 of the Code a provision that Guamanian corporations were not to be treated as foreign corporations. By application of the mirror provisions, United States corporations would be treated as domestic corporations by Guam and would not be liable for the 30 percent tax. See Act of October 31, 1972, 86 Stat. 1494; H.R. Rep. No. 92-1479, 92d Cong., 2d Sess. 3 (1972).

In the court of appeals' view, the congressional action with respect to Guam demonstrated that "[o]bviously, Congress intended a 'two-way mirroring' " (Pet. App. A, p. 12a) with respect to the territorial income taxation generally and this "two-way mirroring" justified its construction of Treasury Regulations, Section 1.1441-4(d). But unlike the Virgin Islands, where Section 28(a) of the Revised Organic Act permits a permanent resident to pay its entire tax liability to that territory, Congress has never allowed a Guamanian corporation engaged in business in the United States to satisfy its tax liability on such United States-source income by payment to Guam. Hence, there was no basis for the court of appeals' extrapolation of the 1972 legislation with respect to Guam to the tax system of the Virgin Islands.

2. While we agree that the decision below is erroneous and that it will have an adverse impact upon the revenues of the Virgin Islands,[2] we do not believe that the question warrants review by this Court. The technical narrow issue is limited to the Virgin Islands and does not affect the tax administration of any of the other territories. Moreover, the holding of the court of appeals turns upon the

[2] In *St. Croix Hotel* v. *Leroy A. Quinn*, D. V.I., Civ. No. 76/365, decided August 15, 1977, appeal pending, C.A. 3, the district court held on the authority of the decision below that a United States resident receiving income from the Virgin Islands is taxable on that income only in the United States, and not in the Virgin Islands. This decision appears to be fundamentally inconsistent with the taxing structures created by the Congress for the two jurisdictions.

interpretation of a Treasury Regulation, which the Treasury may amplify in order to eliminate any uncertainty concerning its application to cases of this type. Finally, Congress can clarify the statutory basis for the Virgin Islands' right to withhold taxes from payments made by Virgin Islands corporations to foreign corporations.[4]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Solicitor General.

STUART A. SMITH,
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[4]As we have pointed out (pp. 6-7, n. 1), Congress has acted in the past to overrule appellate decisions dealing with territorial taxation. See also *Chicago Bridge and Iron Co.* v. *Wheatley*, 430 F. 2d 973 (C.A. 3), certiorari denied, 401 U.S. 910, which held that a United States corporation was a Western Hemisphere Trade Corporation (26 U.S.C. 921) for Virgin Islands tax purposes. This decision was overruled by Section 307 of the Revenue Act of 1971, 85 Stat. 524.

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